Tax Tips

A
NEWSLETTER
FOR
NEW BUSINESSES

courtesy of

The Internal Revenue Service

IRS Tax Assistance Telephone Numbers

1-800-829-1040
for general tax assistance

1-800-829-4477
TeleTax
for recorded tax information

1-800-829-3676
for FREE
tax forms and publications

Inventories:

Taking Stock of Your Business

One of the many necessary but time-consuming tasks people may take on when they enter the world of business is the annual inventory. It's also a tax topic that is frequently misunderstood by people new to the business world, especially in retail businesses.

Before we look at the inventory process itself, a word of caution. For most businesses, certain items should not be included for inventory purposes. Examples would include items that you gave away as gifts, donations, or promotional items, items you used personally and items lost to spoilage or theft. You should keep track of such items separately, since they may be tax deductible under different categories. Be careful that the same items are not included twice under cost of goods sold and other categories such as gifts or samples.

First, the basic definition: an inventory is a thoroughly detailed and itemized list of all the material goods you have on hand to sell, or what will become part of the merchandise you will sell, with the values indicated. You will need to develop a system to identify the items and place a value on them.

The full list should include finished or partially-finished goods and raw materials for manufacturing. You do have to include all items for which you have the legal title, whether you physically have them or not.

Placing a value on the items in your inventory is the key to determining your taxable income for the year. That's why it's especially important to separate from your inventory any items that you did not actually sell or hold for sale.

Generally, there are three methods that you can use to identify the value of your inventory:

Specific Identification Method: Under this system, you identify the true cost of each item by matching it with its purchase price, transportation costs and other factors that affect its cost to you. Generally, this is the method to use for large items, like cars and expensive machinery. If you are not able to keep track of those costs, then you usually have to use one of the remaining two methods.

First-In First-Out (FIFO) Method: Under this method, you assume that the first items you purchased or produced in any year are also the first ones you sold. This is helpful in situations where you have many similar items and cannot match specific items with specific invoices. This method is the one retail stores and similar small businesses normally use.

Last-In First-Out (LIFO) Method: This variation is based on what is essentially the opposite assumption. Here, you assume that the items you produced or acquired most recently are the first ones you sold.

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The value of items that you gave away as gifts or to charity, or things that were spoiled, damaged, or stolen, may be tax deductible and should be recorded separately from your regular inventory. It's also important to keep track of anything you removed from your stock for personal use. Without separate records of these items, you could wind up incorrectly increasing or decreasing your tax bill.

Finally, another reminder about recordkeeping. Clear and accurate business recordkeeping can make the annual inventory go much more smoothly. Ready access to your purchase and cost information, in a purchase journal or cash disbursements journal, will obviously make all of these required calculations easier. Be sure to keep track of your costs for labor, transportation and materials as well.

For more information about inventories, ask for these free publications from the IRS:

- *Publcation 538, Accounting Periods and Methods*
- *Publication 334, Tax Guide for Small Business*

Have Something to Say? We're Ready to Listen.

Small business owners like yourself have an ear at the IRS. The newly established Office of Small Business Affairs listens and responds to tax-related issues facing small business owners.

The office is the national contact to voice concerns or suggestions about IRS policies, regulations and tax laws regarding small business. Its staff will recommend changes to any of these that are unfair or cause undue burden. It will work with other IRS offices to understand small business owners' needs when developing regulations and policies.

The office will also communicate with the Small Business Administration and other federal, state and county government agencies to reduce the small business burden government wide.

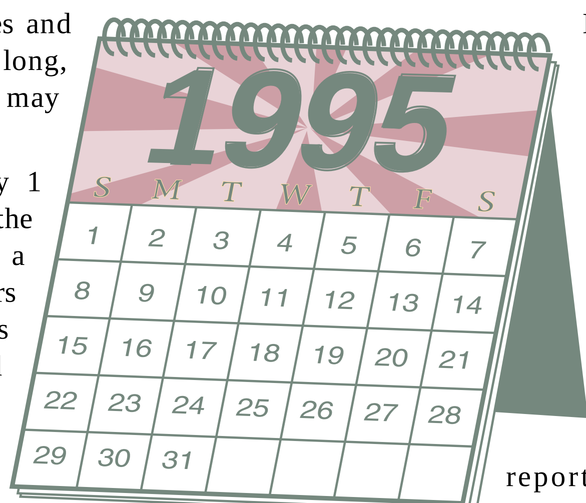
If you have concerns or suggestions about specific IRS policies and tax laws, you can write to the IRS Office of Small Business Affairs, PC, Room 1313, 1111 Constitution Ave. NW, Washington, DC 20224.

Small business owners with problems other than policy issues still have an advocate in the Problem Resolution Program (PRP) office. If you have been unable to solve a chronic tax situation after repeated attempts through normal IRS channels, you can contact the PRP staff for immediate assistance. Call 1-800-829-1040 and ask for PRP.

Understanding all the tax rules for businesses may never be easy, but with the Office of Small Business Affairs tackling problems head on, soon following the rules may not be so hard.

Calendar Year v. Fiscal Year

A year is a year is a year, right? Yes and no. All years are twelve months long, but different types of businesses may need different types of years.



A calendar year runs from January 1 through December 31 — just like the calendar. One of the advantages of a calendar year to small business owners is that payers of interest, dividends and many other kinds of income send their reports to you on a calendar year basis, so it is easier to determine how much income you received for the year. If you operate a sole proprietorship, you would usually have to use a calendar year accounting period.

But some businesses have "seasons" that don't follow the traditional calendar. If your business will have such seasons, you may be eligible to use a 12-month fiscal year that starts on a date other than January 1.

Whether you choose a calendar year or a fiscal year, you must use it on your first tax return. All your records and reporting must follow your chosen year. And, with few exceptions, you must get IRS approval to change your tax year once you have established it.

Choosing a Tax Advisor

You have started a new business. Money is coming in; money is going out. Perhaps you have inventory to be tracked, equipment to be expensed or depreciated, salaries to be paid. Then there are taxes.

Like many people, you may find that, with all your new responsibilities, taxes are just too much to deal with. As a result, you may decide to hire a professional tax preparer—someone who is familiar with the various technical terms and implications of business taxes.

Even if you already have a preparer for your personal tax returns, you may want to conduct a search for someone to look after your business taxes. In the end, it may turn out to be the same person, but at least you'll be sure you've got the one best suited to your business needs.

There are many types of tax preparers who may be qualified to help you. Enrolled agents, attorneys and certified public accountants are all professionals with varying degrees of specialized expertise in finances and federal taxes.

Before selecting a person or firm to handle your business, ask a few questions to see if they offer the services and experience you are looking for.

Experience: Have they worked with businesses similar to yours in size and number of employees? Are they familiar with the general trends in your particular line of business? Do they know about the current tax regulations relating to your type of business?

Service: Can they provide the service you need to meet your tax deadlines? Do they offer to help train you or your bookkeeper to manage the kinds of records that will make tax filings go more smoothly? Are they willing to work with you directly on a continuing basis to improve your tax picture?

Price: What do they offer for the fee they are quoting, and will they guarantee that price? Is it a limited-service fee, or is continuing training and year-round service included? If your return is examined by the IRS, what's their policy on assisting you, and do they charge extra?

References: Ask for a list of clients or others you can contact.

Before you finally settle on a tax preparer, call their references and see what they say. Once you hire a preparer, keep in contact throughout the year, not just at tax time. Good tax planning is a year-round process, and an experienced tax preparer can offer valuable tips all year long.

Liens & Levies

Most tax bills are settled long before any type of collection action is necessary. The IRS sends someone a notice or notices, and that settles the matter. However, if the notices do not take care of things and the person doesn't dispute the bill but doesn't pay it either, the government has some no-nonsense collection tools available.

One of the bottom line tools that the government has to collect its money is the federal tax lien. The Notice of Federal Tax Lien is a legal document that is usually filed at the county recorder's office or with the state where business is conducted.

The lien is a message to anyone who may have an interest in the taxpayer's financial well-being, such as a banker or any other lender, that the government has financial claim to their property. Property may include a home or automobile, and even property the taxpayer may acquire after the lien has been filed. Obviously, a lien can wreak havoc on a credit rating.

The IRS will release a tax lien once a person pays the taxes owed, plus penalties and interest and the cost of filing and releasing the lien, or puts up a bond guaranteeing that the taxes will be paid.

Another tool that can be used to collect taxes is the levy. This allows the IRS to actually take property from someone who owes taxes and sell it to pay the bill. Any balance realized in such a sale above and beyond what is owed to the government may be claimed by that person. In addition to property, the IRS can levy salaries, wages, bank accounts or commissions. Some types of levies remain in effect until the tax debt is satisfied.

More information on this subject is contained in IRS Publication 594, Understanding The Collection Process.

Tax Tips

Internal
Revenue
Service

PC:C:C
1111 Constitution Ave., N.W.
Washington, DC 20224-2686

Taxcalendar

In November

Ask employees whose withholding allowances will be different in 1996 to fill out a new Form W-4.

Ask each employee who can and wants to receive the advance earned income credit during 1996 to fill out Form W-5.

November 1

Deposit payroll tax for payments on October 25, 26 and 27.

November 3

Deposit payroll tax for payments on October 28, 29, 30 and 31.

November 8

Deposit payroll tax for payments on November 1, 2 and 3.

November 9

Deposit environmental, fuel, luxury, retail and manufacturers tax for the last 16 days of October.

November 10

File Form 941 for the 3rd quarter of 1995.

November 13

Deposit payroll tax for payments on November 4, 5, 6 and 7.

November 14

Deposit gas tax for the last 16 days of October if the 14-day rule applies.

November 15

Deposit payroll tax for payments in October if semi-weekly rule did not apply.

Deposit payroll tax for payments on November 8, 9 and 10.

November 17

Deposit payroll tax for payments on November 11, 12, 13 and 14.

November 22

Deposit payroll tax for payments on November 15, 16 and 17.

November 24

Deposit environmental, fuel, luxury, retail and manufacturers tax for the first 15 days of November.

November 27

Deposit payroll tax for payments on November 18, 19, 20 and 21.

November 29

Deposit gas tax for first 15 days of November if the 14-day rule applies.

Deposit payroll tax for payments on November 22, 23 and 24.

November 30

File Form 720 for ozone-depleting chemicals tax for the 3rd quarter of 1995.

File Form 730 and pay the tax on bets accepted during October.

File Form 2290 and pay the heavy vehicle use tax for vehicles first used in October.

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For more information on other excise taxes, see Publication 509, "Tax Calendars for 1995," and Publication 510, "Excise Taxes for 1995."